Sandia Laboratory
Federal Credit Union

May 23, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Dear Mr. Poliquin:

On behalf of Sandia Laboratory Federal Credit Union (SLFCU), the largest credit union in New Mexico with assets in excess of $2 billion and 72,000 members, please accept this comment letter concerning the proposed rule on Risk Based Capital: RIN 3133-AD77. SLFCU serves employees, retirees, and family members of Sandia National Laboratories – one of the state's largest employers – as well as more than 800 select employee groups.

The National Credit Union Administration's proposal to amend the Prompt Corrective Action regulation with the risk-based capital requirements published in the Federal Register on February 27, 2014, is of serious concern to our management and board. We intend to share with you both our broad concerns and some particular concerns that should prompt extensive revision of the proposed rule, especially if the NCUA still has interest in the health of credit unions.

While we certainly appreciate the intent of the proposed regulation, we believe that risk in individual institutions is best identified and addressed through the existing CAMEL rating system, in conjunction with the required net worth ratio. In addition, expedited action should be taken regarding credit unions identified as posing undue risk to the share insurance fund. The existing CAMEL rating system – requiring the review of a variety of risk factors – can better identify the validity and impact of institution-specific risks than can a single risk-based capital ratio. Further, if it can be demonstrated that additional capital is needed systemically, we would argue for a higher required net worth ratio over the more arbitrary risk weightings of the proposed risk-based capital calculation and examiner discretion.

We believe that the underlying focus and the risk weightings of the proposed regulation would place our Credit Union at a competitive disadvantage even though, as currently calculated under the proposed regulation, our Credit Union would still be considered well-capitalized. Historically, our Credit Union has always intended to maintain reserves at a level that would be well in excess of what would be required to be considered well capitalized. Under the proposed regulation, the cushion of capital over which the Credit

Union would be considered well capitalized would shrink by $20.6 million dollars, or 102 basis points.

The NCUA has stated that "Capital and risk go hand-in-hand..." In our review of the proposed regulation, **the level of risk has not been substantiated for the amount of capital required**. This is true in a broad sense, for example when the NCUA states that one intention is to raise the capital requirement for credit unions with concentrations of assets in certain loan portfolios without accounting for the level of risk actually present in those portfolios. In addition, there are many specific examples in which asset risk weightings are proposed without any rationale provided and in defiance of logic, such as when a securitized mortgage investment carries three times the risk weighting of a held mortgage loan even though it's more liquid and involves less credit risk. Based on the proposed risk weightings, it is also difficult to imagine why, given the industry's relative size compared to Federal Deposit Insurance Corporation (FDIC) insured financial institutions, investments and loans are considered to have more risk in a credit union than in a bank.

Additionally, the NCUA has acknowledged that the risk-based capital ratio (like any solitary metric) has inherent shortcomings for assessing risk, but then proposes to cure the situation with broad and unchecked discretionary power to require additional capital as the situation may seem to dictate. **This discretionary power to raise minimum capital requirements effectively undermines a credit union's ability to manage the balance sheet and make strategic plans.** This is clearly not a viable solution. Again, existing CAMEL ratings and administrative actions should address the vast majority of institutional risk. Additional subjective requirements arbitrarily levied through the examination process should not be needed nor allowed.

Further, it should be apparent that the proposed increased capital requirements and asset risk weightings **will actually impede the ability of credit unions to build capital**. If credit unions are discouraged from the very lending that most benefits consumers and local economies, creates jobs and significantly contributes to earnings, or if they are compelled to withdraw from cooperative Credit Union Service Organizations (CUSOs) and forego the cost savings and income they represent, it is unclear for how long the industry will remain independently healthy and viable. Although the intent of the proposed regulation is to ensure credit unions maintain sufficient capital to account for risk in their respective operations, as long as credit unions lack the ability to raise capital from alternative sources other than retained earnings, individual credit unions and the industry as a whole will be at a competitive disadvantage.

Under the proposal, many more credit unions will be forced to look for merger partners at the exact same time as the proposed rules erect new barriers to mergers (such as the removal of goodwill from the risk-based capital ratio), **inevitably creating unnecessary losses for the share insurance fund.**

We question the wisdom of addressing lessons learned from the recent financial crisis with increased capital requirements that clearly can't be considered strictly "risk-based" or creating a "more stable credit union system". However, if the Administration persists in this approach, we offer the following observations with proposal sections referenced. These areas should be clearly identified within the guidance and not left to auditor interpretation if this guidance is formally issued.

INVESTMENTS

1. **[§702.104(c)(2)(ii)(A)]**

   The credit risk presumably accountable for the difference in risk weightings for "cash on deposit" versus "cash on hand" should better account for the guaranteed and insured nature of some types of deposits. We believe that cash and other short/medium term government-backed investments or money in U.S. depositories should not have a risk weighting assigned at all, or at worst, a risk weighting of 20% -- consistent with what the FDIC requires of regulated banks.

2. **[§702.104(c)(2)(ii)(C), §702.104(c)(2)(iii)(A), §702.104(c)(2)(iv)(A), §702.104(c)(2)(vii)(A), §702.104(c)(2)(viii)(B)]**

   The risk weights intended to account for interest rate risk on the weighted average life of various investments does not account for the risk-mitigation inherent in variable rate instruments or other risk-mitigating investment features or contracts.

3. **[§702.104(c)(2)(ii)(C), §702.104(c)(2)(iii)(A), §702.104(c)(2)(iv)(A), §702.104(c)(2)(vii)(A), §702.104(c)(2)(viii)(B)]**

   Risk weightings on investments don't account for the effect of the applicable interest rates or existing yield curve on the potential interest rate risk; this is a severe shortcoming.

LOANS

1. **[§702.104(c)(2)(iii)(B), §702.104(c)(2)(iv)(C), §702.104(c)(2)(v)(C), §702.104(c)(2)(v)(D), §702.104(c)(2)(v)(E), §702.104(c)(2)(vi), §702.104(c)(2)(vii)(C)]**

   The risk-weighting of real estate-secured loans does not take into account the credit quality of the borrowers or the fair value of the collateral —key factors in determining portfolio risk.

   Additionally, the risk weightings proposed in the regulation on non-delinquent first mortgage loans is misplaced. It would seem that the more appropriate focus for risk weightings on loans should be centered on problematic or delinquent loans. Concentration risk buckets should be reduced from three to two and the maximum risk weighting established at 75%.

2. **[§702.104(c)(2)(iii)(B), §702.104(c)(2)(iv)(C), §702.104(c)(2)(v)(C), §702.104(c)(2)(v)(D), §702.104(c)(2)(v)(E), §702.104(c)(2)(vi), §702.104(c)(2)(vii)(C)]**

   Further, the proposal fails to account for geographic and other diversity within the portfolio when assigning asset risk weights.

3. **[§702.104(c)(2)(iv)(B), §702.104(c)(2)(iv)(E), §702.104(c)(2)(iv)(K), §702.104(c)(2)(vi), §702.104(c)(2)(vii)(C)]**

   The risk weightings for:
   - Other Real Estate
   - Current Non-Federally Insured Student Loans
   - Loans to CUSOs

   --relative to other loans represent a capital requirement greater than past loss experience dictates for a credit union like ours; individualized historical loss rates could be used as a factor.

4. **[§702.104(c)(2)(v)(F), §702.104(c)(2)(vii)(D), §702.104(c)(2)(viii)(C)]**

   The concentration risk categories for member business loans should be reduced from three tiers to two, with lower risk weightings on each. Consideration should be given to individual credit unions' past loss experience.

5. **[§702.104(c)(3)(i)]**

   Establishing a higher risk weight for unfunded member business loan commitments further diminishes a credit union's ability to compete and provide much needed, well-underwritten member business loans in communities in which credit unions operate.

<u>CUSOs</u>

1. **[§702.104(c)(2)(ix)(A)]**

   Why is there no risk distinction among the various types of credit union CUSO investments? A CUSO that provides printing services to multiple credit unions represents less risk than a CUSO that originates student loans or MBL loans.

   The exceptionally high asset risk weighting for CUSO investments seems out of all proportion to the amount credit unions have invested and should be managed through the examination process, not by inclusion in a system wide capital calculation.

<u>OTHER ASSETS</u>

1. **[§702.104(c)(2)(v)(H), §702.104(c)(2)(v)(I), §702.104(c)(2)(v)(J)]**

It's perplexing that the fair market value of non-earning assets (land and building, etc.) is not accounted for in the proposed risk-weightings. Further, while a high level of non-earning assets may lower earnings and put pressure on capital, we would venture to say that this is hardly the situation in most institutions; some allowance should be made for the proportion of assets thus constituted.

2. **[§702.104(c)(2)(ix)(B)]**

A more robust explanation and demonstration of how mortgage servicing assets "erode capital" is needed; the dramatic increase in perceived risk of mortgage servicing assets over held mortgages is not adequately justified.

In closing, we hope we've made it easier to appreciate the significant shortcomings of the proposal. We maintain that the existing CAMEL-rating system and net worth ratio is an adequate scheme for risk detection and mitigation. Certainly, more timely action by the Administration against problem credit unions is also needed to close gaps identified from the recent financial crisis.

Respectfully,

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Cc: Honorable United States Senator, Martin Heinrich
Honorable United States Senator, Tom Udall
Honorable House of Representative, Michelle Lujan Grisham
Honorable House of Representative, Ben Ray Lujan
Honorable House of Representative, Steve Pearce
Credit Union Association of New Mexico President, Paul Stull
National Association of Federal Credit Unions President & CEO, B. Dan Berger
Credit Union National Administration President & CEO, Bill Cheney